

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
HODNETT & BRITT :
LIQUOR STORE CORPORATION :
for Revision of a Determination or for Refund of Sales :
Use Taxes under Articles 28 and 29 of the Tax Law for :
the period December 1, 1994 through August 31, 1997. :

DETERMINATION
DTA NOS. 818646
AND 818647

In the Matter of the Petition :
of :
JOHN BRITT :
for Revision of a Determination or for Refund of Sales :
Use Taxes under Articles 28 and 29 of the Tax Law for :
the period December 1, 1994 through August 31, 1997. :

Petitioners, Hodnett & Britt Liquor Store Corporation and John Britt, c/o Leonard Fein, CPA, 911 East 18th Street, Brooklyn, New York 11230, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1994 through August 31, 1997.

A consolidated hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on August 27, 2002 at 10:30 A.M., with all briefs due by January 6, 2003, which began the six-month period for the issuance of this determination. Petitioners appeared by Leonard Fein, CPA.

The Division of Taxation appeared by Barbara G. Billet, Esq. (Robert A. Maslyn, Esq., of counsel).

ISSUES

I. Whether the assessment of sales and use tax which was issued to the business entity was barred by the statute of limitations.

II. Whether the assessment of sales and use tax was void because it was issued as if the business was organized as a corporation while petitioners maintain that, in fact, the business was a sole proprietorship.

III. Whether petitioners have shown that the audit method was unreasonable or that the audit results were incorrect.

FINDINGS OF FACT

1. Petitioner Hodnett & Britt Liquor Store Corporation (“Hodnett & Britt”) was a retail liquor establishment which was located in Brooklyn, New York. On or about November 18, 1997, the Division of Taxation (“Division”) mailed a letter to Hodnett & Britt which scheduled an audit for the period December 1, 1994 through August 31, 1997 at the Division’s offices on December 10, 1997. The letter requested that Hodnett & Britt have all of the books and records pertaining to its sales and use tax liability available on the appointment date including “journals, ledgers, sales invoices, purchase invoices, cash register tapes, federal income tax returns, and exemption certificates. . . .”

2. On January 8, 1998, a meeting was held at petitioners’ accountant’s office. At this time, the Division was presented with certain cash register tapes. Upon examination, the Division found that there were several problems with the cash register tapes. A complete set of cash register tapes for each day of the audit period was not made available. In addition, the cash

register tapes which were produced did not show totals. The auditor also noted that the tapes ended at different times of the day. That is, some tapes ended at 3:00 P.M. and other tapes ended at 8:00 P.M. The Division was also offered Federal returns for the years 1994 and 1995 and bank statements, although statements for some months were missing. In the course of the meeting, the accountant for the liquor store told the Division that the business was a sole proprietorship.

3. During the meeting, the auditor made an additional written request for books and records. Specifically, he requested that petitioners provide the missing bank statements, a daybook, any other purchase invoices, and a general ledger. The auditor never received any additional records.

4. The Division concluded that Hodnett & Britt's books and records were not sufficient to perform a detailed audit because the cash register tapes were incomplete and did not have totals which corresponded to the amounts reported on the sales tax returns, Federal income tax returns or any other documents. On the basis of purchase invoices, the Division determined which firms supplied Hodnett & Britt with its inventory. Thereafter, the Division contacted the firms, Charmer Industries, Inc., Peerless Importers, Inc., Premier Wines and Spirits (formerly Gallo), Star Industries Inc. and Banfry Products Corp., and obtained the wholesale cost incurred by Hodnett & Britt in purchasing its inventory. The Division found that the amount of the liquor store's purchases, according to the liquor suppliers, was \$1,582,086.00, which was more than twice the amount of the liquor store's reported sales during the audit period, i.e., \$746,899.00.¹

¹ The Division does not know how the return of merchandise is reflected in the amounts reported by the liquor suppliers.

Similarly, the liquor store's purchases for the years 1994 and 1995 according to the suppliers were greater than the purchases reported on the Federal schedule C for the same years.

5. In order to calculate retail sales, the Division utilized a markup of 32.63 percent which it derived from information contained in the 1995 Robert Morris Association Annual Statement Studies. The Robert Morris Association Annual Statement Studies is an industrial index which is commonly used in the auditor's office. The Division did not perform a markup test because it did not have any information regarding the sales price of the bottles of liquor during the audit period. Although the cash register tapes showed the amount of a particular sale, they did not identify the item which was sold. The Division multiplied Hodnett & Britt's purchases, according to the suppliers, by the markup to determine that the liquor store had adjusted gross sales of \$2,098,321.00. The reported taxable sales of \$746,899.00 were subtracted from the adjusted gross sales to calculate additional taxable sales of \$1,351,422.00. An error rate of 1.809377 was determined by dividing the additional taxable sales by the reported taxable sales. The error rate was then multiplied by the reported taxable sales to find the additional taxable sales per quarter. A sales tax rate of 8.25 percent was then applied to the additional taxable sales to calculate the amount of additional sales and use tax that was due.

6. The Division issued a Notice of Determination to Hodnett & Britt Liquor Store Corp., dated May 24, 1999, which assessed sales and use tax for the period December 1, 1995 through August 31, 1997 in the amount of \$111,492.28 plus interest in the amount of \$51,095.45 and penalty in the amount of \$92,443.10 for a balance due of \$255,030.83. The Division also issued a Notice of Determination to John Britt, dated September 7, 1999, as a responsible officer or person of Hodnett & Britt Liquor Store Corp. The notice assessed the same amount of sales and

use tax as was assessed against Hodnett & Britt. However, interest was assessed in the amount of \$56,860.43 and penalty was assessed in the amount of \$95,325.59.

7. Prior to issuing the Notice of Determination to the liquor store, the auditor took note of the fact that the business filed its sales and use tax returns as Hodnett & Britt Liquor Store Corp. On the basis of the returns, the auditor decided to issue the assessment to the business as a corporation. The auditor concluded that the status of the business, as reflected on the sales and use tax returns, was more reliable than the information gleaned from the representative of petitioners on January 8, 1998. Petitioner John Britt was considered a responsible officer of the business because he signed a power of attorney form, he signed a waiver of the statute of limitations and he signed the tax returns. Some of the sales tax returns were signed by Mr. Britt as president.

8. Following a conference held by the Bureau of Mediation and Conciliation Services, the amount of tax assessed against Mr. Britt was reduced to \$43,396.07, plus penalties and interest, because the Division had never obtained a consent from Mr. Britt, as an individual, to extend the statute of limitations. The assessment against Mr. Britt was sustained for the period June 1, 1996 through August 31, 1997.

9. Three consents to extend the statute of limitations were executed on behalf of Hodnett & Britt Liquor Store Corp. The first consent extended the time for assessing tax for the period in issue to any time on or before December 20, 1998. The consent was signed by John H. Britt as owner and dated January 16, 1998. The second and third consents were signed by an accountant named Mr. Shore who acted under the authority of a power of attorney. The second consent was dated October 2, 1998 and the third consent was dated January 25, 1999.

10. The Division's file contains a power of attorney authorizing petitioners' current representative, Leonard Fein, CPA, to appear on petitioners' behalf. The corporate taxpayer is listed as "Hodnett & Britt Liquor Store Corp." Mr. Britt's signature on the form is dated May 27, 1999. A stamp on the front of the form shows that it was received by the Tax Compliance Section of the Department of Taxation and Finance on June 3, 1999. No other power of attorney form appointing Mr. Fein as a representative appears in the Division's papers.

11. Mr. Fein met Mr. Britt in the early 1980s. At the time, Mr. Britt was in a partnership with Morris Hodnett and the business was known as John Britt and Morris Hodnett Discount Liquor. Mr. Fein provided accounting services to the business. According to Mr. Fein, the entity filed partnership returns. In or about 1987, Mr. Britt purchased his partner's interest and the business entity became a sole proprietorship.

12. Mr. Fein remained the firm's accountant until the end of 1993 when he sold his accounting practice and moved out of the country for four or five years. While he was away, Shore & Samter, CPAs, provided accounting services to Mr. Britt. At the end of 1998, Mr. Fein resumed his position with Mr. Britt.

13. Mr. Fein did not prepare any of Mr. Britt's sales and use tax returns for the period December 1, 1994 through August 31, 1997. He did not have the opportunity to review any of the information that Mr. Britt would have concerning gross sales, taxable sales or sales tax due because Mr. Britt's former accountants have the records and they would not release the documents to him.

14. Mr. Britt's personal Federal income tax returns for the years 1995 and 1996 included a Federal schedule C which reported that the name of the business was "DISCOUNT LIQUORS."

15. Until the middle of 1997, Mr. Britt was employed as an X-ray technician by Maimonides Medical Center and was not at the business during the daytime. During the period in issue, Mr. Britt drafted checks with insufficient funds and was required to use funds from his pension plan to finance the business.

16. On March 1, 2001, Gallo Wine Distributor, LLC d/b/a Premier Wine & Spirits entered a judgement against petitioners in the amount of \$48,976.10.

SUMMARY OF THE PARTIES' POSITIONS

17. Petitioners contend that there never was an entity known as Hodnett and Brace Liquor Store Corporation. It is submitted that the auditor was made aware of this by the prior representative and from the income tax returns. According to petitioners, since a corporation did not exist, the consents to extend the statute of limitations were not valid. Petitioners also state that Mr. Fein was appointed as a representative before the final consent was signed by the prior representative. Therefore, the last consent was signed by an individual whose power was revoked. In this regard, an affidavit from John Britt states that in January 1999 he sent a letter to New York State stating that George Shore and Samter & Shore were no longer representing him and he was being represented by a new accountant.

Petitioners argue that since the taxpayer is not Hodnett & Britt Liquor Store Corporation but John Britt Discount Liquor, there is no proof that the purchases were made by John Britt's liquor store. In addition, petitioners posit that the industrial survey did not take into account Mr. Britt's store's actual markup, breakage, theft, location, competition and actual amount that he could legally mark up the goods.

Petitioners argue that the store could not have had \$1,350,000.00 in unreported sales because Mr. Britt had to deplete his pension plan in order to pay the store's bills. Mr. Britt had

checks returned for insufficient funds and was sued by vendors for the nonpayment of bills. Petitioners reason that if Mr. Britt had sales in the amount asserted by the Division he would not have had to deplete his pension plan, draft checks with insufficient funds or be in a position where he would be sued for nonpayment to vendors. Further, Mr. Britt had to work full time at Maimonides Hospital to support his family. Lastly, petitioners maintain that since a corporation did not exist, Mr. Britt cannot be a responsible officer of the corporation.

At the hearing, Mr. Fein argued that he filed a form informing New York of the change in business organization from a partnership to a sole proprietorship at the time that Mr. Britt purchased Mr. Hodnett's interest, but the preprinted labels for the sales tax returns did not change and Mr. Britt continued to use the preprinted form. According to Mr. Fein, the firm was never a corporation and never filed a corporate return.

18. The Division argues that petitioners failed to produce adequate books and records during the audit, and therefore, the Division was entitled to estimate the amount of tax due on the basis of external indices. It is also asserted that the audit method employed was reasonable. In this regard, the Division states that the reliance upon third-party information was reasonable and that it would have been impossible to conduct a markup test because there was no proof of actual shelf prices. Further, the Division notes that there was no evidence to support an adjustment for breakage and theft.

The Division also maintains that the business was properly assessed as a corporation because numerous documents such as the sales tax returns and the power of attorney forms support the position that the business was a corporation. The Division states that each of the documents was signed by Mr. Britt as president and on behalf of and in the name of the corporation. In the alternative, the Division contends that even if the business was not a

corporation, issuing the assessment as if the business was a corporation was harmless error which does not result in cancellation of the assessment. The Division further contends that the amount of tax assessed against Mr. Britt was reduced on the premise that the statute of limitations expired for certain periods. However, the Division was not barred from assessing tax against the entity that filed the sales tax returns at the time the notice was issued to John Britt. Therefore, the Division submits that having gained an advantage from the corporation's existence, he should be estopped from denying the existence of the corporation. The Division also submits that if the corporation does not exist it could not file a petition, and as a result, petitioners may not contest the corporate notice.

The Division posits that the power of attorney authorizing Mr. Shore to appear on petitioners' behalf was still in effect when he executed the consent to extend the statute of limitations.

Lastly, the Division contends that petitioners' evidence was legally insufficient, that Mr. Britt is liable for the taxes, interest and penalties due from the corporation and that petitioners have not shown reasonable cause for the abatement of the penalty.

CONCLUSIONS OF LAW

A. The first issue presented is whether the Notice of Determination was improperly issued to Hodnett & Britt Liquor Store Corporation. As noted, petitioners' representative submits that a corporation never existed. According to petitioners' representative, the firm began as a partnership and later became a sole proprietorship.

Initially, it is noted that the explanation offered by petitioners' representative is, at best, incomplete. If the firm started out as a partnership and then changed to a sole proprietorship, the question remains why it filed sales tax returns as a corporation at any time of its existence.

Clearly, there was a basis for the Division to conclude that the firm was organized as a corporation. A corporate name was used on the sales tax returns which had been filed. Some of the returns were signed by John Britt as president. Further, before the notices were issued, two consents were executed, one by John Britt and the other by his representative, which agreed to an extension of time for assessing tax from a corporate entity.

B. The law in New York is clear; defects on the face of the notice will not invalidate the notice, absent evidence of harm or prejudice to the petitioner (*Matter of Agosto v. Tax Commn.*, 68 NY2d 891, 508 NYS2d 934; *Matter of Pepsico, Inc. v. Bouchard*, 102 AD2d 1000, 477 NYS2d 892; *Matter of A & J Parking Corp.*, Tax Appeals Tribunal, April 9, 1992). Here, there is clearly conflicting evidence regarding how Hodnett & Britt was organized. Assuming that the liquor store was organized as a sole proprietorship, there is no evidence that it was prejudiced by receiving a notice issued to it as a corporation. There is no claim that Mr. Britt was not aware that the assessment issued to the business related to the sales tax audit. If there was an error, Mr. Britt was neither confused nor prejudiced by said error. Similarly, Mr. Britt is liable for the taxes due from the liquor store regardless of whether that liability is based upon being a vendor of tangible personal property or an officer who is under a duty to act for the corporation (Tax Law § 1131[1]). Accordingly, the alleged defect in the notices is of no consequence.

C. Petitioners contend that the power of attorney authorizing Mr. Shore to appear on their behalf was revoked by the execution of a new power of attorney before the second consent to extend the statute of limitations was executed. The only evidence to support this contention is the assertion of petitioners' representative and the affidavit of Mr. Britt. In contrast, the evidence in the record shows that petitioners' current representative was not appointed until May 27, 1999 while the second consent to extend the statute of limitations was received by the

Division on January 30, 1999. In the absence of any other documentary evidence to show that Mr. Shore's authority was revoked prior to January 30, 1999, this argument is rejected.

D. The standard for reviewing a sales tax audit where external indices were employed was set forth in *Matter of AGDN, Inc.* (Tax Appeals Tribunal, February 6, 1997) as follows:

a vendor such as AGDN is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (*see*, Tax Law §§ 1138[a]; 1135; 1142[5]; *see, e.g., Matter of Mera Delicatessen*, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, 'the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . ' (Tax Law § 1138[a]; *see, Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43).

When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (*Matter of Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869); exactness is not required (*Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451).

E. Here, on two occasions, the Division requested an opportunity to examine the liquor store's books and records. In response, certain records were produced. However, these records were inadequate to determine the amount of tax due. Petitioners did not offer a complete set of cash register tapes, and those tapes which were produced ended at different times of the day. Further, the tapes did not have totals. In sum, there was no way to verify whether the amounts shown on the tapes were accurate (*see, Matter of Karay Restaurant Corporation*, Tax Appeals Tribunal, December 10, 1998, *confirmed* 274 AD2d 854, 711 NYS2d 853, *lv denied* 96 NY2d

702, 722 NYS2d 794). The significant discrepancy between the liquor store's reported sales and the purchase data provided by the suppliers also justified the use of external indices (*Matter of Roebeling Liquors v. Commissioner of Taxation & Finance*, 284 AD2d 669, 728 NYS2d 509, 512, *appeal dismissed*, 97 NY2d 637, 735 NYS2d 493, *cert denied*, __US __, 154 L Ed 2d 20 [October 7, 2002]).

F. Petitioners' argument that there is no evidence that the purchases were for John Britt's liquor store and that Mr. Hodnett might have opened another liquor store is patently frivolous. If the amount of purchases relied upon by the Division was erroneous, the burden was on petitioners to establish the correct amounts. Similarly, if the audit results were incorrect, the burden of proof was on petitioners to establish the correct markup or the adjustments that should be made for breakage, theft or competition (*see generally, Matter of Licata v. Chu*, 64 NY2d 873, 487 NYS2d 552). Petitioners have not satisfied this burden. Lastly, the fact that Mr. Britt may have been a full-time employee at Maimonides Hospital or that he had to deplete his pension plan to keep the store going does not establish that the audit results were erroneous. The Division does not have the burden of showing what happened to the proceeds of the unreported sales.

G. The petitions of Hodnett & Britt Liquor Store Corporation and John Britt are denied and the notices of determination, dated May 24, 1999 and September 7, 1999, are sustained together with such penalty and interest as may be lawfully due.

DATED: Troy, New York
July 3, 2003

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE